SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 452

CORN EXCHANGE NATIONAL BANK AND TRUST COMPANY, PHILADELPHIA, AND EDWARD C. DEARDEN, SR.,

Petitioners,

vs.

NORMAN KLAUDER, TRUSTEE OF THE ESTATE OF QUAKER CITY SHEET METAL CO., BANKRUPT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

THOMAS P. MIKELL,
ALLEN S. OLMSTED, 2D,
MAURICE BOWER SAUL,
Counsel for Petitioner Edward C. Dearden, Sr.

CHARLES J. BIDDLE,
JAMES McMULLAN,
Counsel for Petitioner Corn Exchange National Bank and Trust Company.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your Petitioners, Corn Exchange National Bank and Trust Company, Philadelphia, and Edward C. Dearden, Sr., respectfully pray that a writ of certiorari issue to review the judgment and decision of the United States Circuit Court of Appeals for the Third Circuit in the above entitled case, reversing a decision of the United States

District Court for the Eastern District of Pennsylvania, which judgment and decision was rendered by the Circuit Court of Appeals on August 12, 1942.

The appeal in the Circuit Court of Appeals was taken from a decree of the United States District Court for the Eastern District of Pennsylvania, holding that the claim of Corn Exchange National Bank and Trust Company, Philadelphia, one of the Petitioners, be allowed as a secured claim in the sum of $7,954.51, and that the claim of Edward C. Dearden, Sr. should be allowed as a secured claim in the sum of $1,550, against the Estate of Quaker City Sheet Metal Co., Bankrupt.

Statement of the Matter Involved.

This case involves the proper interpretation of the new provisions added by the Chandler Act of 1938 to the preference section (Section 60 (a)) [1] of the Bankruptcy Act.

The facts are not in dispute (R. 13, 24). Quaker City Sheet Metal Company (hereinafter called the "Bankrupt"), acting under the supervision of a Creditors' Committee (R. 6, 26, 33) made an arrangement with Corn Exchange National Bank and Trust Company, Philadelphia, one of the Petitioners (hereinafter called the "Bank"), whereby the Bank loaned money to Bankrupt from time to time upon the security of contemporaneous assignments of accounts receivable (R. 18, 32, 34). This arrangement was carried out from May, 1938 until the date of bankruptcy. In addition, certain new contracts were negotiated by the Bankrupt (R. 29, 30). The Bank advanced money to meet payrolls under an agreement giving the Bank an assignment of moneys due and to become due under the contracts (R. 30). As the moneys became due they were again

[1] Act of June 22, 1938 (52 Stat. 869, U. S. C., Title 11, Section 96).

assigned to the Bank and the assignment was noted on copies of invoices (R. 28, 30).

Notice of the aforementioned assignments was not given the obligors of the accounts receivable and moneys due and to become due under the contracts (R. 25, 34). As of the date of bankruptcy there was due the Bank on account of all of the above transactions the principal sum of $7,954.51 (R. 15).

In addition to the above, the Bankrupt obtained from Edward C. Dearden, Sr., one of the Petitioners herein, a loan of $1,550, secured by the contemporaneous assignment of a contract between Bankrupt and York Ice Machinery Company and any moneys due or to become due thereunder (R. 2, 6, 10).

No notice, however, was given to York Ice Machinery Company of this assignment (R. 12, 13, 14).

After the filing on April 15, 1940, of the involuntary petition in bankruptcy, the Bank filed its claim as a secured creditor in the sum of $7,954.51 (R. 15), and Dearden, Sr. filed a petition for reclamation of the sum of $1,550 from the proceeds of the York Ice Machinery contract (R. 2).

The Trustee recognized that the aforementioned assignments were made as security for contemporaneous loans, but resisted Petitioners' claims on the basis of the wording of the second sentence of Section 60 (a) of the Chandler Act. The clause he relied on provides that

> "a transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein . . . ."

This provision, the trustee contended, had effected a change in the previously accepted view of a preference. A bona fide purchaser of the receivable, it was argued, *could* have acquired a right in it superior to the Bank's right by notifying the obligor of the receivable. Therefore the transfer had not been perfected. Therefore it must be deemed to have been made at a date after it was actually made. Therefore the consideration for the transfer, although actually given contemporaneously with the transfer, must be deemed to be antecedent to the transfer. Therefore, it is an antecedent debt, and therefore a preference. Thus the reasoning of the trustee.

Referee in Bankruptcy Henry W. Braude on April 21, 1941, allowed the claims of the Bank and of Edward C. Dearden, Sr. (R. 38, 14). The United States District Court for the Eastern District of Pennsylvania, by Kirkpatrick, J., affirmed the Referee's orders (R. 38). Respondent herein then appealed to the United States Circuit Court of Appeals for the Third Circuit, which, by an opinion filed August 12, 1942 (R. 41), (Judge Jones dissenting, R. 46), reversed the decree of the District Court (R. 46). The holding of the Circuit Court was to the effect that the Chandler Act had changed the law, and, because of the failure to give notice, the assignment to Petitioners of the accounts receivable and moneys due and to become due under the contracts constituted a preference within the meaning of the Bankruptcy Act, as amended.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (43 Stat. 938, U. S. C., Title 28, Section 347), and Section 24 (c) of the Bankruptcy Act of June 22,

1938. (52 Stat. 854, U. S. C., Title 11, Section 47). The judgment of the United States Circuit Court of Appeals for the Third Circuit to be reviewed was entered on August 12, 1942.

Questions Involved.

1. Whether the Chandler Act of 1938 (Section 60 (a) of the Bankruptcy Act as amended) has changed the prior definition of a preference so as to include a transfer of property for a present adequate consideration, when a step in the perfection of the transfer (in this case the notification to the obligor of the assignment of accounts receivable and moneys due and to become due under contracts) is taken after the transfer itself and the payment therefor.

2. Whether notice to the obligor of the accounts receivable and moneys due and to become due under a contract is a necessary step in the perfection of the transfer of such property, within the meaning of Section 60 (a) of the Chandler Act.

Reasons Relied on For Allowance of Writ.

In holding that a transfer of accounts receivable and moneys due and to become due under contracts made contemporaneously with and as security for a loan, is to be deemed as a transfer for or on account of an antecedent debt because of the lender's failure to give notice to the obligors, and thus preferential within the meaning of Section 60 (a) of the Bankruptcy Act, the Circuit Court of Appeals for the Third Circuit

1. Has rendered a decision which the Circuit Court itself (R. 44) recognizes is in conflict with the decision of the United States Circuit Court of Appeals for the

Fifth Circuit in *Adams* v. *City Bank & Trust Co.*, 115 Fed. (2d) 453, decided on November 12, 1940 (cert. denied by this Court, 312 U. S. 699).

2. Has decided an important question of Federal law which has not been but should be settled by this Court, in that it interprets the 1938 amendment to the Bankruptcy Act, as changing the concept of preferences so as to make the question of preference turn, not on whether the consideration for the transfer is present or antecedent, but on whether the transfer is technically perfected at the very moment the consideration passes.

3. Has divided in its opinion, in that two Judges (Maris and Goodrich JJ.) voted for reversal, and one Judge (Jones, J.) voted for affirmance.

4. Has decided an important question of local law relating to the effectiveness of an assignment without notice, in a way probably in conflict with applicable local decisions.

Wherefore, your Petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court of Appeals for the Third Circuit, sitting at Philadelphia, Pennsylvania, commanding that Court to certify and to send to this Court on a day certain to be therein named a full and complete transcript of the record and all proceedings had in this case numbered and entitled on its docket 7893 to the end that this case may be reviewed and determined by this Court; that the said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed by this Court; and that your Petitioners may have such other

and further relief in the premises as may seem just and proper.

And your Petitioners will ever pray, etc.

Edward C. Dearden, Sr.,
By Thomas P. Mikell,
Allen S. Olmstead, 2d,
Maurice Bower Saul,
Packard Building,
15th & Chestnut Streets,
Philadelphia, Pa.,
Attorneys for Edward C. Dearden, Sr.,
One of Petitioners.

Saul, Ewing, Remick & Harrison,
Of Counsel.

Corn Exchange National Bank and Trust Company, Philadelphia,
By Charles J. Biddle,
James McMullan,
1429 Walnut Street,
Philadelphia, Pa.,
Attorneys for Corn Exchange National Bank and Trust Company, Philadelphia,
One of Petitioners.

Drinker, Biddle & Reath,
Of Counsel.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinions of the Referee appear in the Record at pages 14 and 32. The memorandum opinions of the District Court appear in the Record at pages 38 and 39. The opinion of the Circuit Court of Appeals for the Third Circuit appears in the Record at page 41, the dissenting opinion at page 46. None of the foregoing opinions have yet been reported in official reports, except that of the Circuit Court of Appeals, which is reported in 129 Fed. (2d) 824.

Jurisdiction.

The grounds on which jurisdiction of this Court is invoked are set forth in the Petition at pages 4-5 thereof.

Statement of the Case.

The Statement of the Case appears in the Petition at pages 2 to 4, and in the interest of brevity is not repeated herein.

Specification of Errors.

The errors which Petitioners will urge if the writ of certiorari be granted are that the Circuit Court of Appeals for the Third Circuit erred:

1. In holding that where a transfer is made as security for a contemporaneous debt, the same will be deemed to have been made for or on account of an antecedent debt so as to constitute a preference within the meaning of the new provisions of Section 60 (a) of the Bankruptcy Act, if the transfer was not so far technically perfected at the

time the loan was made that no bona fide purchaser from or creditor of the debtor could have acquired any rights in the transferred property superior to the transferee, which holding is erroneous for the following reasons:

(a) The amendment to Section 60 (a) of the Bankruptcy Act does not purport to change the prior rule that a transfer of property by a debtor as security for a contemporaneous loan is not a transfer for or on account of an antecedent debt; compare Section 60 (b).

(b) Section 60 (a) does not purport to change the prior rule and invalidate a transfer which has caused no diminution of the bankrupt estate.

(c) Section 60 (a) does not purport to give the Trustee the status of a bona fide purchaser; sections 70 (a) and (c) of the Bankruptcy Act indicate that Congress did not purport to change the prior law on this question.

(d) The interpretation of the Circuit Court of Appeals creates an unreasonable inconsistency between Section 60 (a) and Section 70 (d), which validates transfers made in good faith after bankruptcy for a present consideration and before adjudication or possession taken.

2. In holding that under the law of Pennsylvania and the Bankruptcy Act, the transfer of a contract right is not perfected as against the Trustee in Bankruptcy of the transferrer until notice of the transfer is given to the obligor.

Statute Involved.

The applicable provision of the Bankruptcy Act of June 22, 1938, is est forth in the Appendix, *infra*, page 14.

Argument.

This case involves the question whether Congress by its amendment to Section 60 (a) of the Bankruptcy Act, has done away with the prior concept that a preference will never result if present adequate consideration is given for a transfer. The Circuit Court of Appeals for the Third Circuit held that a preference will result where the transfer is not technically and completely perfected at the time the loan is made, even though it be for a present adequate consideration.

The first sentence of the amended Section 60 (a) states that a preference must involve a transfer "for or on account of an antecedent debt". The Circuit Court of Appeals held that, because of the new addition of the second sentence to this section, a transfer, although actually made at the same time a loan is made, will be deemed to have been made subsequent to the loan (and thus for an antecedent debt) if the transfer at the moment it is made is not so far technically perfected that thereafter no bona fide purchaser from or creditor of the transferrer *could* acquire any rights superior to the transferee.

This conclusion, it is submitted, gives a broader significance to Section 60 (a) than was intended by Congress. The new amendment was intended to eliminate the inequity which formerly arose where, for example, a transfer was made for or on account of a preexisting debt and then the transfer was perfected by recording within four months of bankruptcy. Under the prior law, such recording related back to the date of the assignment (i. e., more than four months before bankruptcy) and the transfer, even though for an antecedent debt, was permitted to stand as against the Trustee. Under the amended Section 60, this situation

can no longer exist. Congress did not intend to invalidate transfers made for an adequate present consideration.

The decision of the Circuit Court of Appeals in this case is in direct conflict with and diametrically opposed to the decision of the Circuit Court of Appeals for the Fifth Circuit in *Adams* v. *City Bank and Trust Company*, 115 F. (2d) 453, decided on November 12, 1940. That Circuit Court of Appeals held that the new provisions of Section 60 (a) do not make a preference out of a transfer entered into for an adequate present consideration, although the transfer is not perfected until subsequently (in that case by recording) while the debtor is insolvent and less than four months before the bankruptcy. The Circuit Court of Appeals in the present case recognizes that its decision is in conflict with the holding in the above case (R. 44).

The question whether the Chandler Act has changed the concept of a preference, particularly with reference to assignments of accounts receivable, has invoked considerable discussion, but has not been decided by this Court. Authorities are divided.[2]

It is significant that if the Circuit Court of the Third Circuit is correct in its interpretation of Section 60 (a), then a lender can never be certain that his security is safe, unless it is clear that the transfer is effective so that under the laws of all of the states of this country, and all the countries of the world, no one *could* obtain a superior right.

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[2] See: 4 *Remington on Bankruptcy* (4th Ed.) Sec. 1717; *Neyhoff, Assignment of Accounts Receivable as Affected by the Chandler Act*, 34 Ill. Law Review 538 (1940); *Hamilton, The Effect of Section 60 of the Bankruptcy Act upon Assignments of Accounts Receivable*, 26 Va. Law Review 168 (1939); *Kach, Transfers of Non-Negotiable Accounts and the Chandler Act*, 46 Commercial L. J. 133 (1941); *Compare: McLaughlin, Aspects of the Chandler Bill to Amend the Chandler Act*, 4 U. of Chic. L. Rev. 369, 388 (1937); *Mulder, Ambiguities in the Chandler Act*, 89 U. of Pa. L. Rev. 10, 25 (1940); 3 *Collier on Bankruptcy* (14th Ed.) Sec. 60.48.

In addition to the above, it is submitted that the Circuit Court of Appeals for the Third Circuit has misinterpreted *Phillips' Estate #4*, 205 Pa. 525. The latter decision held that notice is not necessary in order to perfect an assignment of a contract right, although failure to give notice may result in other persons acquiring superior equities.

The *Pennsylvania Act of July 31, 1941*, P.L. 606, 69 Pa. Purdon's Statutes, Section 561, which dispenses with the necessity of giving notice in Pennsylvania of an assignment of accounts receivable, but which was not applicable to the present case, does not make the question moot in Pennsylvania. If the Circuit Court is correct, then, in spite of the Act of 1941, it is possible that a subsequent bona fide purchaser in another state, having a different law, *could* acquire a better title to accounts receivable owing to a creditor in Pennsylvania. Moreover, the same interpretation of the Chandler Act would apply to conditional sales, bailment leases and other forms of collateral not mentioned in the 1941 act.

The question involved here is of great and imminent importance to the commercial world, for it goes to the very root of lending money on the security of contemporaneous assignments. Unless banks and other lending institutions can be assured that such loans will not be deemed preferences under Section 60 (a) as amended, they will be unable safely to engage in the fundamental practice of lending money on the security of assignments of many types of personal property. Its bearing on the financing of war contracts is obvious.

Conclusion.

It is, therefore, respectfully submitted that, for the foregoing reasons, this Court should grant the Petition for Certiorari.

Respectfully submitted,

THOMAS P. MIKELL,
ALLEN S. OLMSTEAD, 2D,
MAURICE BOWER SAUL,
Packard Building,
15th & Chestnut Streets,
Philadelphia, Pa.,
Attorneys for Edward C. Dearden, Sr.,
One of the Petitioners.

SAUL, EWING, REMICK & HARRISON,
Of Counsel.

CHARLES J. BIDDLE,
JAMES MCMULLAN,
1429 Walnut Street,
Philadelphia, Pa.,
Attorneys for Corn Exchange National Bank and Trust Company, Philadelphia,
One of the Petitioners.

DRINKER, BIDDLE & REATH,
Of Counsel.

APPENDIX.

Bankruptcy Act of 1938 (Chandler Act):

SEC. 60. PREFERRED CREDITORS.—a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, * * * the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy * * * it shall be deemed to have been made immediately before bankruptcy.

b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefitted thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: PROVIDED, HOWEVER, That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee * * *.

c. If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security

of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

* * * * * * *

SEC. 70. TITLE TO PROPERTY.—a. The trustee of the estate of a bankrupt * * * shall * * * be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy * * * to all (1) documents relating to his property; (2) interests in patents, patent rights, copyrights, and trade-marks, and in applications therefor: * * * (3) powers which he might have exercised for his own benefit, but not those which he might have exercised solely for some other person; (4) property transferred by him in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition he could by any means have transferred, or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered: * * * (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to his property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverter, and like interests in real property, * * * and (8) property held by an assignee for the benefit of creditors * * *. All property which vests in the bankrupt within six months after bankruptcy by bequest, devise, or inheritance shall vest in the trustee * * *. All property in which the bankrupt has at the date of bankruptcy an estate or interest by the entirety and which * * * becomes transferable * * * solely by the bankrupt shall * * * vest in the trustee * * *.

c. * * * The trustee, as to all property in the possession or under the control of the bankrupt at the date of bankruptcy or otherwise coming into the possession of the bankruptcy court, shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a

creditor then holding a lien thereon by legal or equitable proceedings, whether or not such a creditor actually exists; and, as to all other property, the trustee shall be deemed vested as of the date of bankruptcy with all the rights, remedies, and powers of a judgment creditor then holding an execution duly returned unsatisfied, whether or not such a creditor actually exists.

d. After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs—

(1) A transfer of any of the property of the bankrupt, other than real estate, made to a person acting in good faith shall be valid against the trustee if made for a present fair equivalent value or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien upon the property so transferred; . . .